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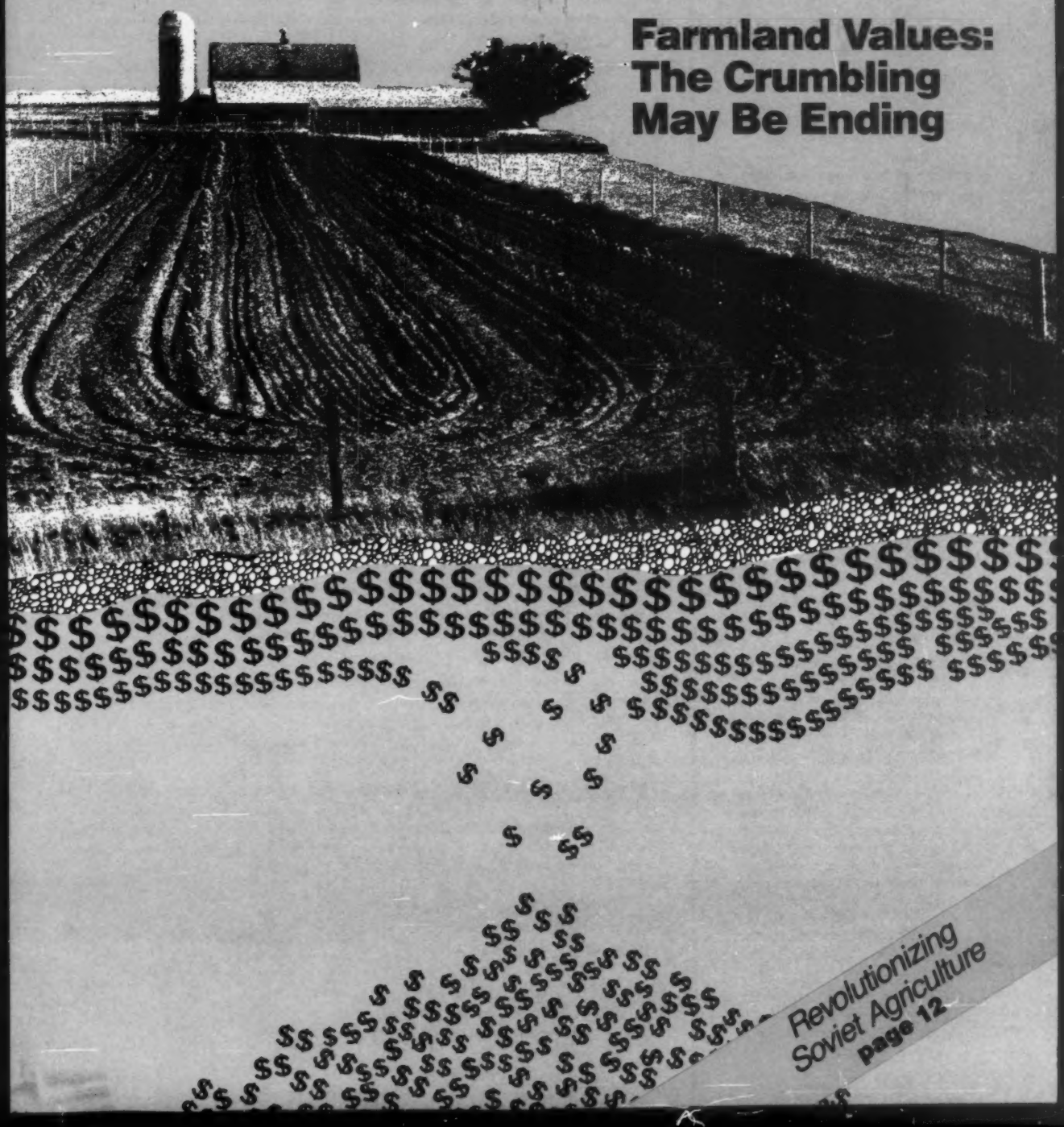

Farmland Values: The Crumbling May Be Ending

Revolutionizing Soviet Agriculture
page 12

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PERSPECTIVES

THE FARM BILL OF 1985 has a designated lifetime of 5 years. But will it survive that time period without major changes? There are no guarantees. Farm policymaking often seems to be as much a gamble as farming itself.

Has the 1985 law been a success so far? "Yes, it's working," says Barbara Stucker, an economist in USDA's Economic Research Service. "It hasn't caused a complete turnaround in the farm economy in a year and a half, but it wasn't designed to."

U.S. agriculture is being shifted toward a market orientation, says another ERS economist, Kathryn Lipton. She adds: "The FSA (Food Security Act, the official name of the farm bill) includes steps to bring U.S. production more in line with demand, thereby reducing stocks." Lipton says the farm sector still has three critical problems: surplus stocks of commodities, more debt than many farmers can handle, and high government costs.

"The FSA has been expensive, and that is a major reason for suggestions that changes are needed," Stucker says. The cost of federal farm programs was $25.8 billion in 1986 and is expected to be $25.3 billion this year. This spending level is about twice what was anticipated when the bill was being written, Stucker says. "One of the major reasons for the higher cost is that the rest of the world has matched us dollar for dollar in lowering prices, and this was not expected."

In order to influence other nations to change their farm policies or production levels, Stucker says, the United States must be persistent in its effort to move toward a market orientation. Most policymakers realized that this would be costly, at least in the short run, the economists say. Barring unforeseen international disruptions, U.S. farm program costs should be substantially lower toward the end of the 5-year life of the 1985 act, Stucker says.

Several proposals being talked about by policymakers, Lipton says, "would be significant departures from current programs." One is "decoupling," which would separate government support payments from production decisions. After a phase-out lasting several years, there would be no more production controls or payments linked directly to production levels. "More and more people seem to be deciding that this is the way to go," Stucker says. Other proposals include mandatory production controls and "targeting," which would tie benefits to farm characteristics and the needs of individual producers.

"The current farm programs still distort economic signals to farmers," Lipton says, because benefits remain linked to production. Stucker adds: "The FSA encourages farmers to behave competitively in marketing, but not in production."

Congressional leaders are saying that they do not expect any significant changes in farm policy this year. But hearings have been held on several proposals during recent months. "The biggest factor in possible changes in the 1985 act will be the 1988 election," Stucker says. "If news from the farm sector continues to improve, there won't be as much inclination to change the FSA."

Lipton says that the challenge for policymakers is to "achieve the dual goals of income support and a market-responsive farming sector." Changes on the international scene cause added difficulty. The volatility that has plagued the farm sector is likely to remain in the years ahead, she adds, "because closer economic ties among nations mean that general economic contractions or expansions strongly affect an export-oriented U.S. agriculture."

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FEATURES

Drop in Farmland Values May Be Ending *by Doug Martinez* 4

U.S. farmland decreased in value by about a third in 5 years. But the decline slowed in most areas during the last year. Values have even been moving back up in a few states, and the overall decline might be about to end, according to the latest land sales figures.

Farm Credit System Faces a Long Climb Back *by Juliana King* 8

From a rock-solid financial powerhouse to a crippled giant, the Farm Credit System has suffered a dizzying plunge. Its own policies, as well as the agricultural recession, are blamed for the fall. The FCS has appealed to Congress for help. Structural changes in the system are being considered, to prevent future similar crises.

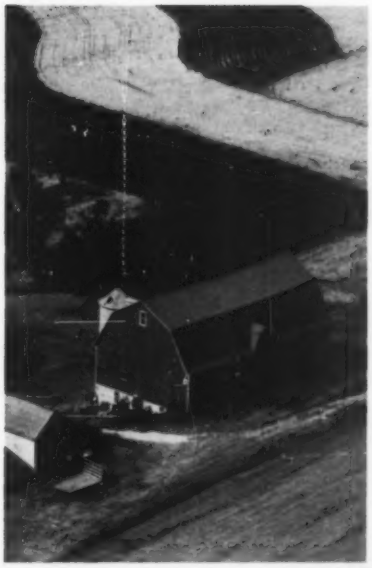
Are Soviet Farm Reforms Beginning to Pay Off? *by Jack Harrison* 12

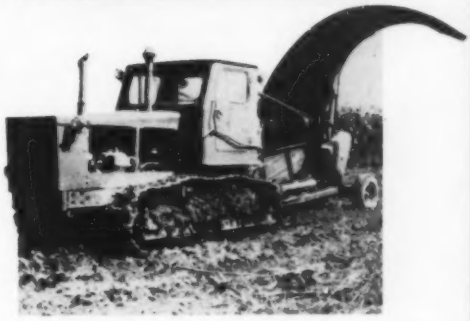
A good grain harvest last year in the Soviet Union was followed by assertions that the "intensive technology" program is working. Soviet officials are aiming for self-sufficiency, and perhaps even exporter status, in wheat and other grains. But it's too early to tell if permanent improvements have been achieved.

DEPARTMENTS

Reports in the News: U.S. Farm Trade Data; African Food Imports 7

Agricultural Roundup: Stress on Rural America; Outlook for Exports 14





Drop in Farmland Values May Be Ending

The sharp slide in farmland values is slowing, and might even be ending, according to analysts of USDA's Economic Research Service.

As of February 1 this year, the nationwide average value per acre was $548. That figure was 8 percent lower than a year earlier, an improvement over the back-to-back 12-percent drops from 1984 to 1985 and 1985 to 1986.

These are averages, of course. In some states plagued by the lingering farm crisis, land values fell by 18 percent or more in 1986. Yet 16 states showed increased farmland values in 1986, compared with 11 in 1985, and 21 states had smaller declines in 1986 than 1985.

"The continuing downturn in values reflects the large acreage of land offered for sale relative to demand, concern about lower crop prices, and uncertainty over farm programs," says economist William Heneberry, who analyzes farmland values for ERS.

But Heneberry says the worst of the long slide in values may be over now. "There are reports," he says, "of stable and even increasing values in the past few months, particularly in the Midwest. Some real estate brokers have reported increases in both the number of sales and inquiries about land for sale. Many buyers are established farmers paying cash to expand their current holdings, but nonfarm investors also are reportedly becoming more active in the market."

Further evidence of stabilizing farmland values comes from Federal Reserve Banks, whose 1987 first quarter reports showed increasing values in many districts.

Among the larger geographic areas, only the Northeast showed a regionwide increase in 1986. The sharpest declines were suffered in the nation's midsection, from the upper Rocky Mountain states east to the Great Lakes and south to the Mississippi Delta and Texas plains.

"In the Corn Belt and Northern Plains, which experienced losses of around 50 percent in the last 5 years, declines appear to be moderating," says Heneberry. He points out that the declines were lower in the last quarter of 1986 than in the first three quarters.

"There are reports of stable and even increasing values in the past few months."

State Averages Varied Widely

At the state level, the ranges were even wider than those of the regions. In Louisiana, farmland values fell 27 percent, and in Minnesota, 19 percent.

On the plus side, New Jersey's farmland value soared 36 percent. Pennsylvania was next, with an increase of 19 percent.

The ERS researchers say farmland values nationwide have fallen by a third in the last 5 years. When adjusted for inflation, the value of American farmland has dropped to its lowest level since the mid-1960's.

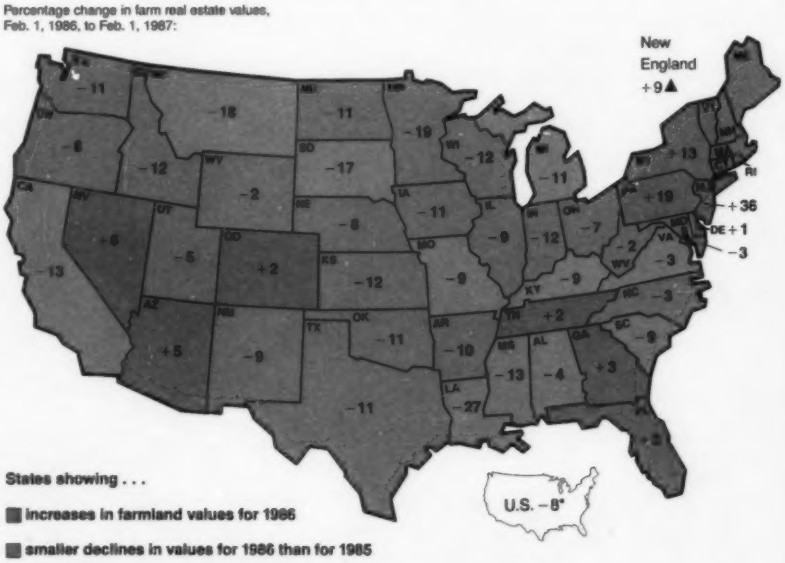
The U.S. average farmland value of $548 an acre (which excludes Alaska and Hawaii) includes all classes of farm and ranch land, from semi-arid rangeland to high-value vineyards and orchards near urban areas. State average values ranged from a high of $5,321 an acre in New Jersey to a low of $122 an acre in New Mexico.

For the nation as a whole, farmland values peaked in April 1982 at $823 per acre.

Regional variations can be accounted for, at least in part, by land-use differences and location. In New England, for example, farmland values are far higher than in other regions because of the closeness to urban areas and the consequent competition for

Farmland Values Rise in 16 States and Fall in 32, with 21 of the 32 Showing Smaller Declines Than in the Previous Year*

Percentage change in farm real estate values, Feb. 1, 1986, to Feb. 1, 1987:



States showing . . .

- **increases in farmland values for 1986**
- **smaller declines in values for 1986 than for 1985**
- **equal or greater declines for 1986 than for 1985***

*Excludes Alaska and Hawaii. ▲Includes Conn., Mass., Maine, New Hampshire, Rhode Island, and Vermont.
*Includes one state, Virginia, that showed an increase in value in 1985.

farmland from residential and commercial interests.

Other factors affecting value include resource issues, such as the diminishing availability of groundwater for irrigated cropland in the Texas High Plains.

Cash rents are closely related to farmland value. "Although declining in most major agricultural states," says Heneberry, "rents in some areas decreased less than the value of rented land, so that rent-to-value ratios remained high."

For instance, cash rent for Iowa cropland fell 8 percent from February 1986 to February of this year, to $80.29 an acre on average. But the value of cropland fell 11 percent, raising Iowa's rent-to-value ratio from 9.3 percent in 1986 to 9.8 percent this year.

"Competition among tenant farmers and part-owner operators for rented land may have prevented cash rents from falling further," says Heneberry. Gross returns to rented cropland were above 9 percent in several midwestern states.

In contrast, rents in the Northeast failed to keep pace with rising land values, causing rent-to-value ratios there to move lower.

Overall Values Affected

Obviously, the overall value of farmland has been seriously affected in the last 5 to 6 years. The declines have been harshest in the Corn Belt, Great Lakes states, and Northern Plains.

For states, the single sharpest drop came in Iowa. In February 1981, the total value of Iowa's farmland (including both land and buildings) stood at $67.4 billion. Declines each year since then have trimmed the total value by more than $42 billion to $25.1 billion this February. In at least 5 other states, total farmland values were more than halved from February 1981 to February 1987.

The hopeful sign is that these declines have become smaller. In many cases, the largest drops came between 1984 and 1985. That's when Iowa lost nearly $15 billion in the value of its farmland—from $50.4 billion to $35.8 billion. By comparison, the $3.1 billion drop from February 1986 to February of this year was the smallest in 6 years. □

[*Based largely on information provided by economists William Heneberry and Charles Barnard of the Resources and Technology Division, Economic Research Service.*]

(Related story on next page.)

Few Foreigners Buying U.S. Farmland

Foreign interests aren't snapping up large amounts of American farmland, countering concerns that may have intensified as land values have fallen and distress sales increased.

As of December 31, 1986, foreign ownership of U.S. farmland remained at less than 1 percent of privately owned U.S. agricultural land, according to USDA's Economic Research Service. Foreign interests held 12.4 million acres by the end of last year, 369,000 acres more than the figure reported at the end of 1985.

However, a number of land parcels are owned only in part by foreign investors, says attorney Peter DeBraal, an ERS analyst who prepares the annual report for USDA.

"When the 12.4 million acres are adjusted for these partial interests, the total foreign-owned acreage drops to an equivalent of 11.4 million acres," DeBraal says.

The report, required under the Agricultural Foreign Investment Disclosure Act of 1978, shows that forestland accounts for more than half of the foreign-owned acreage, and that the largest number of acres owned by foreign persons was in Maine.

"Foreign holdings in Maine account for 10 percent of Maine's privately owned agricultural land and represent 15 percent of all the reported foreign-owned agricultural land nationwide," says DeBraal. "Three companies own 91 percent of the foreign-held acres in Maine, all in forestland. Two companies are Canadian and the third is a U.S. corporation which is partially foreign owned."

Except for Maine, DeBraal says, "foreign holdings are concentrated in the South and West. Rhode Island is the only state with no reported foreign-owned agricultural land."

Under the disclosure law, all foreigners owning U.S. agricultural land as of February 1, 1979, had to file a report of such holdings with the Secretary of Agriculture by August 1, 1979. Moreover, all foreign persons who acquired or disposed of U.S. agricultural land on or after February 2, 1979, have been required to report such transactions within 90 days of the transfer.

In addition, says DeBraal, reports must be filed for changes in foreign ownership or land use. DeBraal's findings are based on an analysis of such reports submitted to USDA.

Most of the U.S. agricultural land held by foreign interests, 70 percent, was owned by citizens of the United Kingdom, Canada, West Germany, the Netherlands Antilles, or Switzerland.

"Foreigners do not appear to be taking purchased agricultural land out of production," DeBraal notes. "No change in intended use at the time of filing was reported for 92 percent of the acreage."

Volatility in Values Unprecedented

For most farmers, perhaps, the fall in farmland values that started in the early 1980's is the only one they can remember.

Apart from modest and little-noticed dips in 1939 and 1950, farmland values had steadily climbed from 1933 to 1982.

Far more prominent in the minds of many farmers is the spectacular increase from 1972 to 1981 when values grew by more than 10 percent each year.

"Overall," says ERS economist William Heneberry, "land values increased by 275 percent from February 1972 to February 1981." The reasons were simple enough: the largest farm export boom in U.S. history gave a golden tint to American farmland, and favorable credit conditions encouraged farmers to finance the purchase of land with borrowed funds. Also, the rapid appreciation of values provided an opportunity to acquire "paper wealth" and encouraged the bidding up of prices. That, in turn, created an appreciation psychology which fed on itself.

With the severe export declines and tightening of credit in the 1980's, farmland values have plummeted, proving once again that "land values are sensitive indicators of the financial outlook in the farm sector."

According to Heneberry, "the expectations for continually increasing farmland earnings and inflation changed sharply in the early 1980's. By early 1987, farm real estate values had fallen by percentages unprecedented since the Great Depression. When adjusted for inflation, land values in the United States had fallen 45 percent below the 1980 level. In the Corn Belt, values were only 36 percent of the inflation-adjusted value in 1980."

This boom-and-bust period for farmland values has been more volatile than any other in our history, Heneberry says.

Even after the 1930's had done their damage to land values, the improvements in the value of farmland were fairly level, unlike the sharp upward spirals of the 1970's.

Heneberry can make that statement with the assurance of authority based on historical data.

From 1850 through 1910, information on the value of farmland was collected in the decennial U.S. census. And in 1912, USDA began its annual estimates of farmland values.

Changing Farmland Values

"Land values early in the nation's history were affected by the efforts of the federal government to dispose of land and encourage widespread ownership of land," says Heneberry. As it acquired land through purchase or union, the government sold land to obtain revenue and to satisfy the demand of settlers moving westward.

Several legislative acts, beginning with the Land Ordinance of 1785, provided for the survey and sale of public land. Prices were unbelievably low by today's standards, varying from $1 to $2 per acre. Competition from states and individuals reselling their land kept values low for undeveloped tracts.

"By 1820," notes Heneberry, "the price had dropped to $1.25 per acre and the minimum size of tracts being sold was 80 acres."

Land offered for sale then, however, looked a little different from the cultivated land usually found in farms for sale these days.

"Measuring changes in value over long periods of time requires an understanding of how farmland has changed," says Heneberry. "Raw land usually requires some application of capital and labor before farming can begin. Much of the eastern half of the nation was forested and had to be cleared before substantial acreages could be farmed."

Adding Value to Farmland

Heneberry cites a historical report on Iowa to demonstrate the difference in value between raw and developed farmland.

"In 1836," he says, "undeveloped land could be purchased from the federal government for $1.25 an acre. But breaking (plowing) the prairie cost $2 per acre, fencing with rails added another dollar, and buildings, including the farmer's cabin, were estimated at $1.50. Thus, purchase of an operating farm might require $5 or $6 per acre, and some farmers were asking $10 or more per acre for a fully developed farm."

After the establishment of USDA's annual estimates in 1912, even more precise measures could be made of changing land values.

"The early days of this century were relatively prosperous for agriculture. By 1920, spurred by demand produced by World War I, land values had reached $69 per acre, 60 percent above 1915," says Heneberry. "The farmland value boom was quickly reversed in 1921, though, when falling farm commodity prices put financial pressure on farmers and ended the speculation in land among nonfarmers. Values decreased gradually in the 1920's, falling to $49 by 1928. And a much steeper decline began in 1930 as the Great Depression affected the entire economy."

By 1933, he says, values had dropped to $30 per acre, 29 percent below 1930 and 56 percent below the 1920 high.

Although values leveled off after 1933, and rose in the 1940's and 1950's, memories of the Depression may have dampened even larger increases, says Heneberry.

"Nevertheless, values more than doubled from 1940 to 1950, and rose 80 percent from 1950 to 1960," he says. "During the 1960's, American agriculture was relatively stable. Inflation and farm mortgage rates were relatively low, and federal price support programs were in place to support commodity prices and farm income. The U.S. average farmland value rose moderately, from $117 in 1960 to $203 in 1971, an average compound increase of 5.1 percent annually."

Japan Remains Our Best Customer

Although more than 150 countries import U.S. agricultural products, our top ten foreign customers accounted for 60 percent of U.S. export sales last year.

Japan was in its usual first place position, taking $5.1 billion worth of American farm goods. Its purchases included more than $1 billion in U.S. coarse grains, $877 million in oilseeds, and $667 million in red meats.

The Netherlands, which also transships to other nations, was the destination of record for around $2.1 billion in products from U.S. farms. Oilseeds, feeds, and fodders were the major items.

Canada spent around $1.5 billion, roughly one-third of that on American fruits and vegetables. Other billion-dollar buyers were South Korea, Taiwan, Mexico, and West Germany.

Adding in Egypt, Italy, and Spain, the ten largest markets took $15.5 billion worth of U.S. agricultural products. Our total farm exports in 1986 came to $26.0 billion.

For the first time in several years, the Soviet Union was not among the top ten. Its purchases dropped from $1.9 billion in 1985 to $658 million in 1986.

The report (from which this ranking of markets was compiled) provides a comprehensive set of statistics on the value and quantity of U.S. agricultural exports by commodity and country. Similar data are presented on U.S. agricultural imports. The report covers 1986 and a few preceding years.

Top Markets for 1986 U.S. Farm Exports

Ten top buyers	U.S. ag exports
	millions
Japan	$5,106
Netherlands	$2,089
Canada	$1,547
South Korea	$1,293
Taiwan	$1,164
Mexico	$1,074
West Germany	$1,042
Egypt	$ 805
Italy	$ 720
Spain	$ 701

Foreign Agricultural Trade of the United States, Calendar 1986. *(Published May 1987; 309 pages of trade data; GPO Stock No. 701-026-00020-9; $11.00.)*

Africa Faces Hard Choices

Africans suffer most from the economic problems on their continent, but these problems could also have an impact on the food-exporting nations, according to a recent Economic Research Service report.

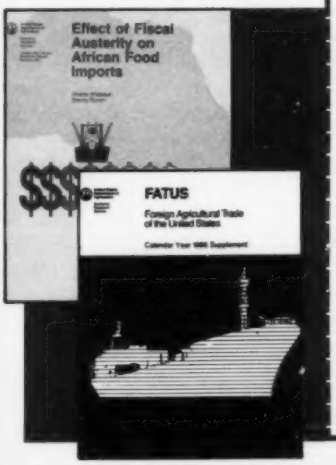
In their study of 25 African nations, the authors note that the region grew increasingly dependent on food imports over the last two decades. Food exporters benefited from greater sales, and the imports gave Africa's consumers a greater quantity and variety of food.

Today, however, the two major factors influencing the region's ability to import food are threatened. The large infusions of credit provided during the 1970's are being withdrawn, as creditors demand repayment on past loans. At the same time, the export earnings of most of the African nations are stagnant or declining, and a larger share of these earnings must now go to service their huge debts.

The choices that Africa is being forced to make will have long-term consequences for its economic growth — and its future ability to import. Faced with the need to curtail purchases, most nations try to maintain basic food imports at the expense of other items.

This analysis offers no simple solution to the continent's "financial crisis." The creditworthiness of African nations is expected to remain fragile. Moreover, most of these nations depend on a few primary export commodities already suffering from depressed markets.

Effect of Fiscal Austerity on African Food Imports *by Shahla Shapouri and Stacey Rosen. (Published May 1987; 59 pages of text and tabular data; GPO stock No. 001-019-00515-7; $3.25.)*



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Farm Credit System Faces Long Climb Back

For decades, the Farm Credit System was considered one of the safest and most stable members of this country's financial establishment. But the farm lending giant now stands humbled, and it's appealing for federal help to climb out of a deep financial hole.

As late as February, FCS officials were saying they needed only legislative changes in the system's charter—not necessarily financial aid—to keep the system afloat. However, in May that position changed, and FCS formally asked Congress for $6 billion in aid.

So how did FCS, which reported $80 billion in assets in 1985, get stuck in the quagmire that has pulled it downward for more than 2 years? According to economists with USDA's Economic Research Service, the answers lie not only in the shocks of the agricultural recession, but also in the structure and basic policies of the Farm Credit System during the 1970's.

The system, a cooperative of 37 banks in 12 districts, finances farmland purchases and provides operating loans to producers and various cooperative agribusinesses. The three branches in each district that make up the FCS are the Federal Land Bank (FLB), the Federal Intermediate Credit Bank (FICB), and the Bank for Cooperatives. In each district, the FLB and FICB are owned by local associations called Land Bank Associations and Production Credit Associations. These associations are the initial contact point for the farmers and others who borrow—thereby becoming owner/members—from the system.

Despite this structural diversity, the FCS is still a single-sector lender in a sector (agriculture) that temporarily went bad. Yet there's more to the story than that.

"FCS's financial woes, as with those of other farm lenders, are rooted in the system's lending policies during the agricultural boom of the previous decade," says ERS economist David Freshwater. Increases in farm income, exports, and farmland values in the 1970's fueled an expansion that led to expectations of continued agricultural growth. Farmers, encouraged by readily available credit and

The perception was that U.S. farm prosperity was here to stay, and farmers were willing to take on more and more debts.

the hope of ever-rising income, expanded their operations, updated equipment and facilities, and added to their landholdings. The strong demand for farm real estate eventually inflated prices far above the earnings potential of agricultural land.

Growth in Lending

The perception was that U.S. farm prosperity was here to stay, and farmers were willing to take on more and more debt. The number of farmers borrowing from FCS increased, as did the amount of money the FCS was willing to lend them. FCS's loan volume between 1971 and 1979 grew from $14.8 billion to $47.9 billion.

Prior to 1971, the system would lend only 65 percent of the value of farmland. As the farm economy boomed, expectations grew that land values would continue to rise. The Farm Credit Act of 1971 amended FCS's charter, allowing the agricultural lender more flexibility in setting lending limits.

In the early 1970's, FCS began lending borrowers a higher percentage of their collateral. Often, banks within the system would lend up to the limit—85 percent of the value of the asset used to secure a loan. (Later legislation would allow the system to lend up to 97 percent of the appraised value of land if the loan held a government guarantee.) This exposed FCS to greater risk if the farmers missed their payments. When the value of farm assets fell, particularly land prices, so did the value of the FCS portfolio. Essentially, FCS was basing many of its lending decisions on the assumption that asset values would continue to appreciate, rather than on the farmers' ability to generate enough income to pay their debts.

Because such decisions were not made on the income-generating ability of an asset, loans would not "cash flow" when income failed to rise as expected, says ERS economist Greg Gajewski. As recessions hit both the general U.S. economy and the farm economy, it gradually became clear that many farmers (and their lenders) had overextended themselves and would be unable to pay off their loans or honor their commitments, he adds.

Those who borrowed heavily in the late 1970's entered the 1980's with sky-high interest costs. In 1982, land values peaked and began their downward spiral. This cut into the collateral on which much of the borrowed money was based, nudging many farmers into higher risk categories and limiting the amount of new credit they could obtain.

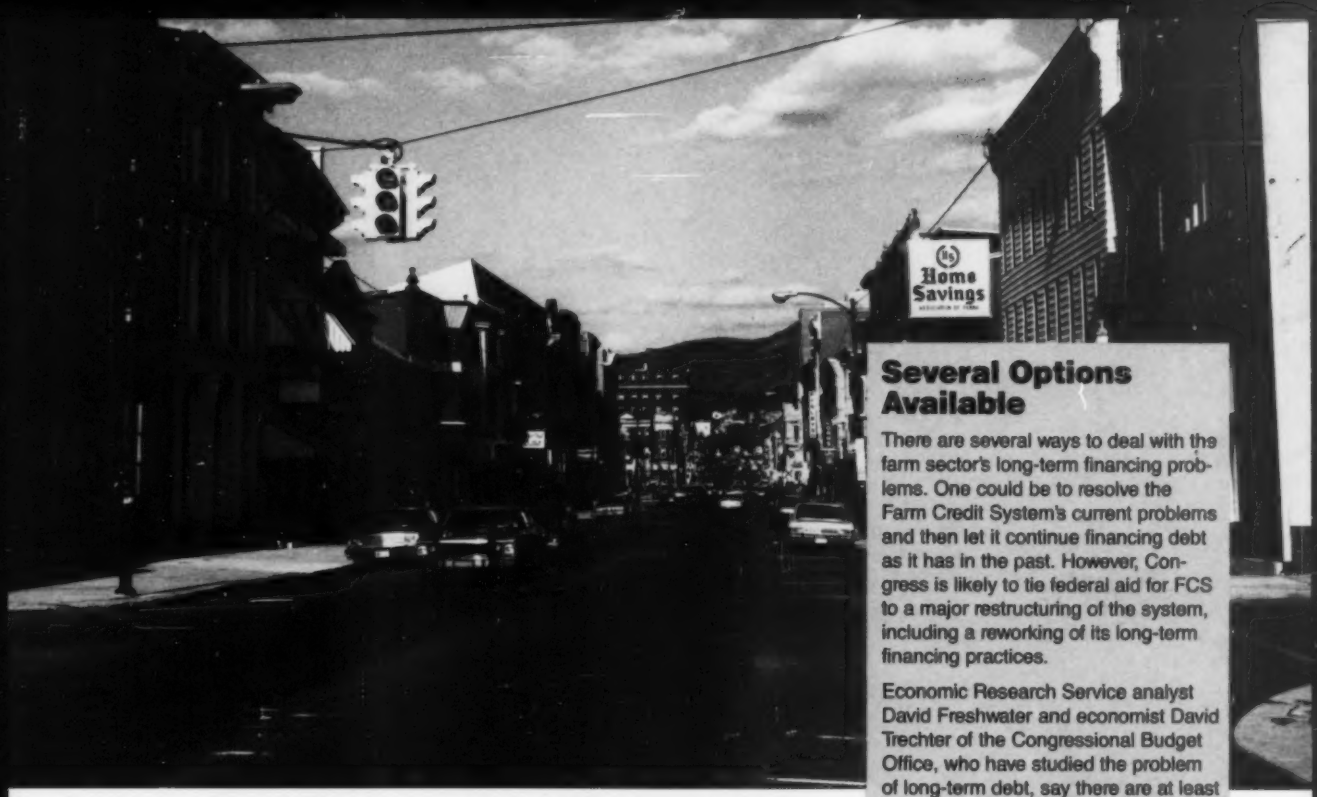
Although lenders did not feel the full impact of the farm financial crisis as quickly as heavy borrowers, FCS fast became the most financially strapped lender. "Part of the reason is that the system is a single-sector lender," says Freshwater. "FCS depends entirely on agriculture. When the farm economy changes, the effects on FCS are substantial. So while agriculture expanded during the 1970's, so did the

Farm Credit System Loan Total Has Been Falling, While Net Earnings Remain Negative

	Total in performing loans	Net earnings
	billion dollars	
1979	59.0	0.5
1980	69.2	0.9
1981	78.9	1.0
1982	81.1	1.1
1983	80.8	0.5
1984	78.1	0.4
1985	64.4	−2.7
1986[1]	51.2	0.2
1987[2]	48.7	−1.4
1988[2]	47.9	−1.1
1989[2]	48.5	−0.8
1990[2]	49.4	−0.4

[1]1986 figures reflect changes in FCS accounting policy. [2]FCA forecasts, 1987-90.

Source: Farm Credit Administration, *Financial Forecast of the Farm Credit System*, April 1987.



Restructuring of the Farm Credit System is aimed at minimizing future economic stress on rural communities as well as farmers.

FCS. Now the sector has contracted, and the system must adapt," he adds.

An Advantage Turned Sour

Besides the burdensome debt resulting from the failed real estate loans made by the Federal Land Banks, other problems plague the system. Many of FCS's strong borrowers have been paying off their loans at rapid rates—primarily because FCS, in recent years, has been charging higher interest rates than other commercial lenders.

Historically, FCS offered borrowers rates that were often several percentage points below those of other lenders. FCS could do this because the system based its lending rates on the average cost of its financing funds. This approach, which worked in its favor by attracting borrowers when interest rates were rising, worked against it as interest rates in general began to fall. Eventually, says Freshwater, this "average-cost pricing" locked the system into paying, and charging, higher interest rates. Lenders who base loan rates on their current cost of financing were in a much better position to pass on declining interest rates to their borrowers.

FCS's average cost of funds began to rise during the late 1970's and early 1980's, when it issued a number of long-term bonds that cannot be redeemed before their maturity dates. Interest rates at that time were high compared with past rates, but the system expected rates to climb even higher. By averaging, FCS blended higher current financing costs in with the lower rates of older notes and bonds, enabling it to offer lower loan rates than its competitors, says Gajewski.

Because FCS is still paying the higher costs, it has lost its competitive edge, Gajewski adds. As a result, some of the more financially sound farmers have switched to lenders with cheaper rates, leaving the FCS with fewer good loans and an increasing share of financially troubled borrowers.

The cumulative effect has been an overall decline in FCS's volume of performing loans (loans being paid on schedule)—dropping from the 1982 peak of $81 billion to $51.2 billion at the end of 1986. Even FCS says this has hurt its ability to attract new business. The system expects its market share to continue declining—perhaps through 1989. According to FCS, its share of real estate loans this year could decline

(continued on next page)

Several Options Available

There are several ways to deal with the farm sector's long-term financing problems. One could be to resolve the Farm Credit System's current problems and then let it continue financing debt as it has in the past. However, Congress is likely to tie federal aid for FCS to a major restructuring of the system, including a reworking of its long-term financing practices.

Economic Research Service analyst David Freshwater and economist David Trechter of the Congressional Budget Office, who have studied the problem of long-term debt, say there are at least four options available to supplement existing lending arrangements. These are:

- Establishing a commodity-based loan system — allowing farmers to obtain loans based on the value of the commodity they expect to produce. This would tie loan payments directly to commodity prices, allowing payment levels to fluctuate with price changes and adding flexibility to repayment periods.
- Developing shared-appreciation mortgages — enabling the lender, in exchange for lower rates or more money, to share in the profits when farmland is sold.
- Warehousing foreclosed land — under which the federal government would hold foreclosed farmland until land prices increased to a specified level.
- Developing a secondary mortgage market for farmland loans similar to the Fannie Mae, a secondary home-mortgage market that essentially underwrites home mortgages. Depending on how it is structured, the secondary market for farmland loans could eventually eliminate the need for a specialized agricultural lender like FCS.

Lenders Show Some Optimism

Many lenders are "cautiously optimistic about an improving financial picture for agriculture, providing federal farm assistance programs remain strong," say economists Greg Gajewski and Steve Koenig. But none of these lenders think the bad times are yet over, they add.

By the end of 1986, farm debt had fallen to $169 billion from the 1983 peak of $205 billion. The primary reasons for this include the writing off of bad loans, debt pay-downs by financially sound farmers, and a reluctance to take on new debt even by farmers who could afford to, says Gajewski. This means that while lenders are absorbing bad debt, they are also faced with a reduced loan volume as well-off farmers resist borrowing more money.

Nevertheless, some lenders' cautious optimism appears based on the declining rate at which loans are becoming delinquent. For banks and life insurance companies, that rate has declined two quarters in a row, Koenig points out. Delinquent short-term loans issued by commercial banks — loans that are no longer accumulating interest plus those 90 days past due — fell $400 million in 1986.

Insurance companies, which have drastically reduced new farm loans, have reorganized their farm lending operations. They now are concentrating on servicing and restructuring existing loans and managing acquired properties. Financial stress felt by the major insurance companies may have peaked, say the economists.

However, high delinquency rates and increased loan losses will continue for many agricultural lenders. The failure rate for commercial banks specializing in farm finance will likely edge toward 75 a year for the next several years, Gajewski says.

to 38.4 percent from 40.7 percent of the market in 1986. FCS expects its share of farm operating loans to fall from 12.7 percent to 11.6 percent of the market in 1987.

The declining loan volume poses another problem for FCS—the rising cost of servicing its remaining loans. Because the system has less and less revenue available to support overhead and administrative costs, there is even more pressure on FCS's already strained earnings, the analysts point out.

Totaling Up the Losses

FCS, as a whole, lost a total of $4.6 billion in 1985 and 1986. "In fact, only 3 of the 12 separate banks in the system are making close to adequate returns," says Freshwater. "Four have negative returns." During the first 3 months of 1987, the system lost $155 million. While less than the $205 million loss reported in the same period in 1986, this "improvement" does not necessarily signal a turnaround for the beleaguered lender, say the analysts.

FCS Chronology: From the Heights to the Depths

	General Economy	Farm Credit System
1970	U.S. economy, followed by the agricultural sector, begins to expand.	FCS holds 23 percent of all farm real estate loans.
1971		1971 Farm Credit Act decentralizes lending procedures and increases the amount of money that can be lent on collateral.
1972		Expansion of farm sector is followed by growth of the FCS—the system increases the amount it lends to an increasing number of member/borrowers.
1973	United States shifts to flexible exchange rate. U.S. dollar drops in value compared to world currencies.	
1974	U.S. farm exports continue to rise.	
1975	General economy in recession. Farmland values begin to rise. Inflation starts to climb.	
1976	General economy begins 4-year expansion.	
1978	U.S. dollar begins 3-year decline.	
1979	General interest rates climb into high teens.	FCS's share of farm real estate loans reaches 35 percent of the market. FCS issues a substantial number of long-term, "uncallable" bonds at high financing rates.

Many of FCS's problems are regionally distributed, but the crisis will continue to affect the entire system, the economists say. The Federal Land Banks, however, will be the biggest problem. Just over 67 percent of the outstanding debt in the entire system in 1986 was held by the land banks. These banks, with all of their unwanted landholdings, are the crux of the system's problems, says Freshwater.

The Production Credit Associations — the shorter term lenders for FCS — have $1.4 billion in surplus funds, or earnings that were carried over from previously profitable years. But because the PCA's are distinct organizations, their surplus funds are currently unavailable to help offset the land banks' losses. Instead, with authority granted by the 1986 Farm Credit Act Amendments, the FLBs' have dipped into their borrowers' stock for $260 million in funds. (FCS borrowers are required to purchase between 5 and 10 percent of the value of the loan in either Federal Land Bank or Production Credit Association stock, depending on the type of loan.

	General Economy	Farm Credit System
1980	General economy in recession.	Farm Credit Act Amendments allow FCS divisions to pool capital, share losses, and exchange loans.
1981	General interest rates begin 3-year decline. U.S. dollar begins 5-year climb in value.	FCS earnings begin to decline.
1982	General economy in recession. Tight monetary policies reduce inflation. Interest rates remain high. U.S. farm exports begin 2-year descent.	
1983		FCS's share of farmland loans reaches 43 percent of the market.
1984	Strong economic growth pushes up general interest rates. U.S. farm exports recover a little.	FCS's loan base begins to shrink.
1985	General interest rates, agricultural exports, and U.S. dollar decline.	Farm Credit Act Amendments formalize loss-sharing agreements and provide funds for ailing districts. Farm Credit Capital Corp. created to stabilize FCS. FCS reports losses of $2.7 billion.
1986	Agricultural exports continue to decline. General economy slows. U.S. dollar continues to fall.	Farm Credit Act Amendments cut Farm Credit Administration's authority and require annual review of the system. FCS's 1986 losses total $1.9 billion.
1987		FCS continues to deteriorate. In May, FCS asks Congress for $6 billion in federal aid.

Congress, which is working on a solution to the Farm Credit System's problems, has already tried several times to resolve the crisis. The 1985 Amendments to the Farm Credit Act restructured the system and granted more flexibility to allow the system to help its troubled banks. In 1986, further amendments eased the system's interest-setting and accounting practices. The changes turned out to be temporary first-aid only, and FCS's financial position continues to worsen, the two economists agree.

If nothing were to be done to permanently resolve the system's current problems, FCS could be forced to shut down, says Freshwater. The immediate problem, he says, is that FCS may soon be unable to issue bonds to raise funds and would have to speed up the rate at which farmers pay back their outstanding loans and mortgages. In addition, farmers who have borrowed from the system could risk losing the FCS stock they were required to purchase. The reason, he says, is that bondholders providing funds to FCS have first priority by law to recoup their investments.

The eased accounting rules in the 1986 amendments allow FCS to spread some of its losses over 20 years to avoid putting borrowers' stock at risk. "Most banks plan to use the new accounting standards, and all will continue to retire the stock at book value. So as lenders pay off their loans and redeem their stock, they'll get what they originally paid," Gajewski explains.

Once the system's current financial dilemma is resolved, a solution must be found to prevent the crisis from recurring. Long-term debt financing was and is the biggest problem prompting the financial turmoil engulfing FCS. "Congress will likely review the basic structure of the system and may try to redefine FCS's role to reduce the probability of future crises," says Freshwater. □

[*Based on information provided by economists David Freshwater, Greg Gajewski, and Steve Koenig of the Agriculture and Rural Economy Division, Economic Research Service.*]

Are Soviet Farm Reforms Beginning to Pay Off?

The Soviet Union always has big plans for its agriculture—and frequently, big disappointments.

But 1986 was a year of success, and maybe this time some permanent improvements are being achieved in the Soviet agricultural sector.

Last year's grain crop of 210 million metric tons was the largest in 8 years, prompting official praise for the "intensive technology" program that was started a few years ago.

General Secretary Mikhail Gorbachev has been telling visitors from the West that within 6 years his country will be an exporter of grain, instead of an importer. Another goal is production of 250 million tons of grain annually by 1990.

"This is a very ambitious goal, and highly unlikely to be achieved," says Christian Foster, an economist in USDA's Economic Research Service. He adds, however, that the Soviet grain growers surprised a lot of people with the size of the 1986 crop.

This year the official Soviet goal is 232 million tons of grain, which would be the second largest crop ever. But weather has been a problem, including a dry fall, a cold winter in many areas, and late thawing. The USDA, therefore, has projected a Soviet grain crop somewhat smaller than last year's.

Detailed information about Soviet agriculture is difficult to come by. "We don't have enough facts yet to fully explain the size of the 1986 crop, but it's possible the intensive technology program is creating results," Foster says.

Improvements Publicized

The recent success has been a popular topic in the Soviet media, where full credit is given to the agricultural reforms. A radio report from Moscow not long ago asserted: "Much attention has been paid to the proper use of intensive technology, since it was shown that last year (in Odessa province) each hectare of land thus worked yielded an average of 14 quintals of extra grain." (That's about 21 additional bushels per acre.)

Foster says Gorbachev may be seeing some results from his farm program, but is still a long way from the goal of national self-sufficiency in grain. "The Soviet Union will continue to be a net grain importer for at least the near future. However, with an excellent year weather-wise, it might find itself a net grain exporter, particularly of wheat. As for whether the USSR could ever sustain a position as a net grain exporter, even in 10 or 15 years, no one knows," Foster says.

"Profit incentives also have apparently had an effect on production."

Intensive technology was introduced in 1984 on test areas, then reportedly applied to 17 million hectares (42 million acres) of grain in 1985, and to nearly twice that much area last year, Foster says. The program involves more and better use of fertilizers, pesticides, and higher yielding crop varieties, improved machinery and soil management practices, an upgrading of the transportation system, and increased training for agricultural workers.

"Profit incentives also have apparently had an effect on production," Foster says. New rules tie pay for all agricultural employees to production results. Farm workers are paid under collective contracts, and the compensation of farm managers and specialists is determined partly by production levels.

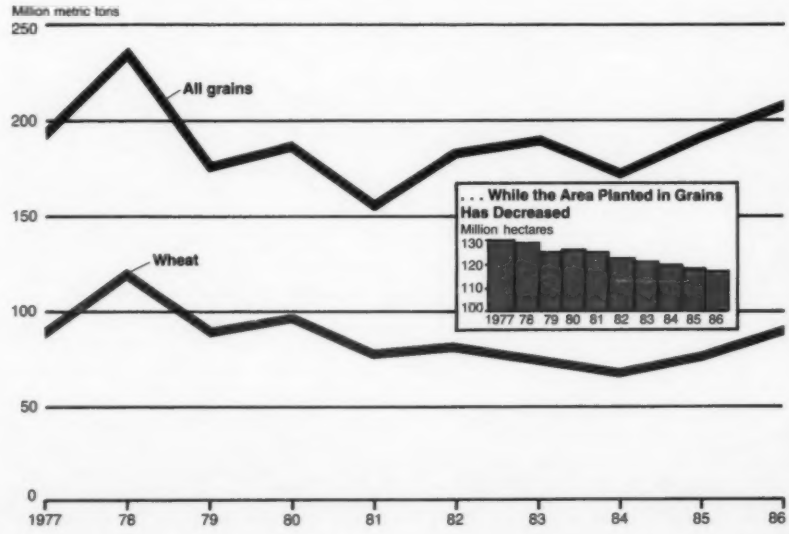
Gorbachev's economic gains appear to be the result of "eliminating slack from a relatively stagnant economy," instead of from any structural changes in the system, Foster says.

Other factors that may have influenced the 1986 harvest include increased research, crackdowns on alcoholism and mismanagement, and good weather at harvest time, Foster says.

"A complex set of factors comes into play, and it's difficult to know exactly how important each has been."

Weather is often a crucial consideration in bumper crops, but was probably not the main reason for the good Soviet crop in

Soviet Grain Production Has Increased the Last 2 Years . . .



1986. "Overall, the weather was not exceptional," Foster says. Some areas were hit by drought in the spring and summer, but weather at harvest was good nearly everywhere.

Area in Grains Reduced

The new agricultural strategy includes reduced plantings in the poorer soils, Foster notes. The 116.5 million hectares harvested last year represented the sixth straight year of cutbacks in the amount of land devoted to grains.

In 1986 the Soviet wheat yield was 27 bushels per acre, the highest since the record, set in 1978, when the weather was nearly perfect. In comparison, the United States had an overall yield of 34 bushels per acre last year, Canada 33, Argentina 27, Australia 23, and the European Community 68.

Soviet wheat production of 92 million tons in 1986 was 16 percent above the average for the preceding 5 years.

Even with the good crop in 1986, the Soviet Union has maintained a high level of grain imports. U.S. analysts are not sure why. "Low grain prices, subsidized sales, a desire to add to stocks, and damage to the 1987 crop are all possible factors," Foster says.

Also, Soviet use of grain for feed has been at a record level, as livestock numbers reached highest-ever totals. And more feed probably was needed because of the very cold winter and spring weather.

Much Room for Improvement

Virtually every aspect of Soviet agriculture will have to be improved if production goals are to be met, Foster says. Weaknesses include delays in the transportation of crops and inputs, inadequate processing and storage facilities, and a poorly maintained rural road system. "These are major problems, and they won't be solved quickly."

On the positive side, fertilizer applications to small grain crops were at a record level in 1986, up 20 percent from 1985, the economist notes.

Soviet officials reported a 5.1 percent increase in agricultural output for 1986, a better rate of gain than for any other sector of the economy. Included were significant increases in animal products, grains, vegetables, and fruits, but decreases in cotton and sugarbeets. A slight increase was reported in nongrain feeds.

Since Gorbachev became the Soviet leader, planners have been slightly more realistic with their agricultural goals. The 1982 Food Program called for unreachable production levels of 238-243 million tons annually in the 1981-85 period and 250-255 million tons in 1986-90. The revised plan calls for production of 250-255 million tons in 1990, instead of during the entire 5-year period.

The Food Program was a response to the slow agricultural growth of the 1970's, and it included some decentralization of agricultural decisionmaking. One of its major aims was achieving self-sufficiency during the 11th 5-Year Plan (1981-85). Needless to say, that achievement remained far out of reach.

In 1981-85, Soviet grain production actually averaged less than during the two preceding 5-year plans. A record 237 million tons of grain was produced in 1978, but for 1981-85 the average was 180 million tons a year.

Much of the shortfall was made up with imports, which averaged about 40 million tons a year in 1981-85, nearly twice the level of the preceding 5 years. □

[*Based primarily on information provided by economist Christian Foster of the Agriculture and Trade Analysis Division, Economic Research Service.*]

Signals Mixed on Soviet Imports

Poor crops in the Soviet Union can mean increased sales for American farmers, through export of surplus U.S. commodities.

Thus Soviet reports of increased production and better farm-sector efficiencies could be bad news for American agriculture.

This year the signals are mixed. Despite a good Soviet grain crop in 1986, the volume of U.S. grain exports to the Soviet Union in calendar 1987 is expected to be at least three times the total of the previous year.

The 2.7 million tons exported in 1986 was all corn. This year's total is up substantially because of the Soviet agreement to buy 4 million tons of wheat through a U.S. export enhancement program. Corn sales are also larger this year, at least 50 percent more than in 1986.

However, the value of U.S. farm exports to the Soviet Union may not keep pace with the volume increase this year, because prices are lower. Soybean sales also are down. The Soviets bought no U.S. soybeans in 1985 and 1.5 million tons in 1986. They have bought none in 1987.

In 1986, the value of U.S. agricultural exports to the Soviet Union hit a 13-year low, at $658 million—only about a third of the total for the previous year.

The decline reduced total U.S. exports (farm and nonfarm products) to the Soviet Union to about $1.26 billion, almost 50 percent below 1985. Farm exports accounted for only 52 percent of the total value, compared with an annual average of more than 72 percent from 1975 through 1985.

The Soviet Union was the second largest market for U.S. farm products in 1984 and 1985, but fell to twelfth last year.

Soviet agricultural imports from all countries in 1987 are expected to be close to the 1986 level of $15 billion.

AGRICULTURAL ROUNDUP

Stress Changing Rural America

The following material is excerpted from a recent Economic Research Service report assessing the impact of farm financial stress on rural America. The report, written by economists Mindy Petrulis, Bernal Green, Fred Hines, Richard Nolan, and Judith Sommer, will be highlighted in next month's "Reports in the News" section.

During the past 30 years, the economic structure of rural America has become more diversified, significantly diminishing its overall vulnerability to changes in natural resource markets, commodity prices, and farm conditions. The economic future of most rural citizens is now tied more to overall national economic growth than to the success or failure of any one business sector.

This is not, however, the case for the residents of farming-dependent rural counties or for other individuals whose economic fortunes are tied directly to agriculture.

Until now, major disruptions of farming-dependent communities have been averted because much of the economic distress in the agricultural sector has been concentrated in only 11 percent of farm operations. Although many farmers in this group are under pressure to leave farming, the actual losses (bankruptcies and foreclosures) are not as dramatic as might be suggested by the number who are under severe financial stress.

Even if a large proportion of the highly stressed farm operators were to leave farming in any one year, this displacement would not be nearly as great as the annual loss of farms that took place throughout the 1950's. In fact, the present restructuring of agriculture has involved mostly ownership changes of existing farms, rather than substantial declines in the total number of farms.

As a result, it appears that up until now rural communities have been able to absorb many of the displaced farmers, either through existing jobs or through creation of new ones.

Further restructuring in the agricultural sector seems unavoidable, at least in the short run. Although both interest rates and the value of the dollar dropped substantially in 1986, major problems such as excess capacity, low commodity prices, diminished export markets, and high debt levels continue to plague the farm economy.

If these trends accelerate, more farm sales, foreclosures, and bankruptcies are inevitable. And more farm operators will have to face difficult economic adjustments in the immediate future. This bloc of farmers will be made up of large operators and, perhaps, an increasing number of smaller operators who rely on off-farm employment for a major part of their household income.

In the more farming-dependent areas, these adjustments can be most difficult for communities that lack a diversified economic base and the potential for job growth. Their limited capacity to absorb more displaced farmers may translate into not only a loss of farm families but also additional job and population losses in the local service and retail sectors.

The resulting financial stress for rural governments would mean that without outside help from state and federal governments, many will be unable to provide a stable environment for economic growth, or even manage population decline effectively.

Because the problems may turn out to be widespread and affect entire regions, an argument exists for the federal government to play a role in helping to restructure the farm sector and to ease the adverse effects. For example, one possible option might be broadening USDA's direct responsibility for farmers' welfare to encompass the transition of marginal farmers to other occupations. Programs to help displaced farmers find new jobs could include a federal presence in providing education and training, helping ex-farmers start new businesses, and easing capital losses associated with leaving agriculture.

A determination by USDA not to abandon producers as soon as they stop active farming would fulfill a long-time commitment to these people who, because they have been farmers, are not well served by the nation's social safety net programs such as unemployment compensation. Moreover, federal involvement could lessen disruption and promote the orderly movement of surplus human and physical capital resources out of agriculture, benefiting the rest of the farm sector and the nation as a whole.

Leaders

World's Leading Nations in 1985 Per Capita Consumption of Beef, Pork, and Poultry

Beef and veal		Pork		Poultry	
Country rankings	Pounds per capita[1]	Country rankings[2]	Pounds per capita[1]	Country rankings	Pounds per capita[3]
1. Argentina	178.1	Hungary	175.7	Israel	95.0
2. Uruguay	146.4	East Germany	137.6	Saudi Arabia	79.8
3. United States	108.5	Denmark	124.1	United States	69.7
4. Canada	90.6	Czechoslovakia	114.9	United Arab Emir.	65.0
5. New Zealand	90.4	Austria	114.9	Hong Kong	64.8
6. Australia	90.4	West Germany	114.2	Kuwait	59.3
7. France	68.1	Belgium-Lux.	101.9	Canada	55.1
8. Switzerland	62.4	Hong Kong	101.4	Hungary	49.2
9. Panama	61.7	Switzerland	98.3	Australia	47.8
10. Soviet Union	61.1	Bulgaria	94.6	Spain	47.2
11. Italy	60.8	Poland	84.4	Venezuela	45.9
12. Belgium-Lux.	60.0	Taiwan	83.8	Iraq	44.3
13. Czechoslovakia	58.6	Netherlands	82.0	Romania	39.5
14. West Germany	51.1	France	76.9	Taiwan	39.2
15. Ireland	50.9	Romania	70.3	France	39.0

[1]Carcass-weight equivalents. [2]The United States ranked 21st, at 65.5 pounds of pork per capita. [3]Ready-to-cook basis.
For more information, contact economist Linda Bailey (202) 786-1691.

An Improving Export Outlook

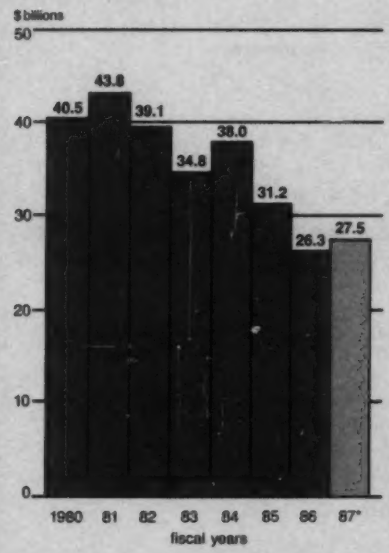
In their latest review of prospects for U.S. agricultural exports, USDA forecasters concluded that the picture had brightened considerably in the last few months. In response, they raised their projections of both value and volume for fiscal 1987.

They now expect export earnings to rise more than $1 billion above 1986's 9-year low. Lower U.S. prices will hold down the gains in earnings but are helping to revitalize volume, which may rebound above the levels of the last 2 years.

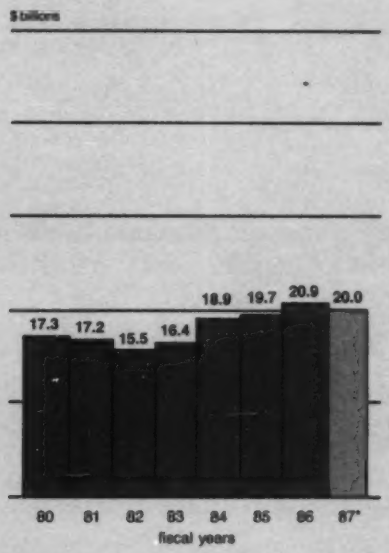
Meanwhile, U.S. agricultural imports are expected to decline slightly after climbing for 4 straight years. The combination of higher export earnings and reduced imports will give a needed boost to America's farm trade surplus.

Forecasters project:

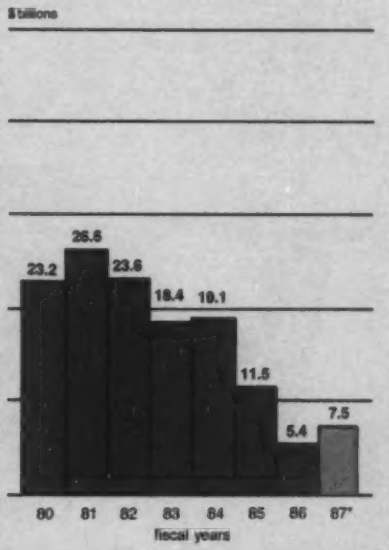
. . . The First Rise in U.S. Agricultural Export Earnings in 3 Years



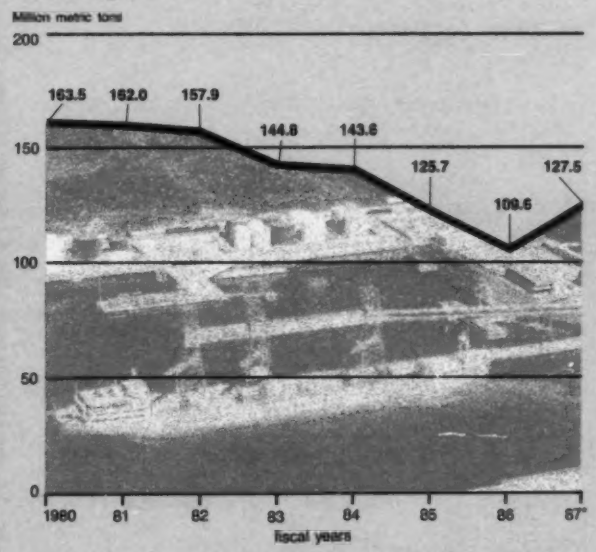
. . . A Small Decline in U.S. Agricultural Imports



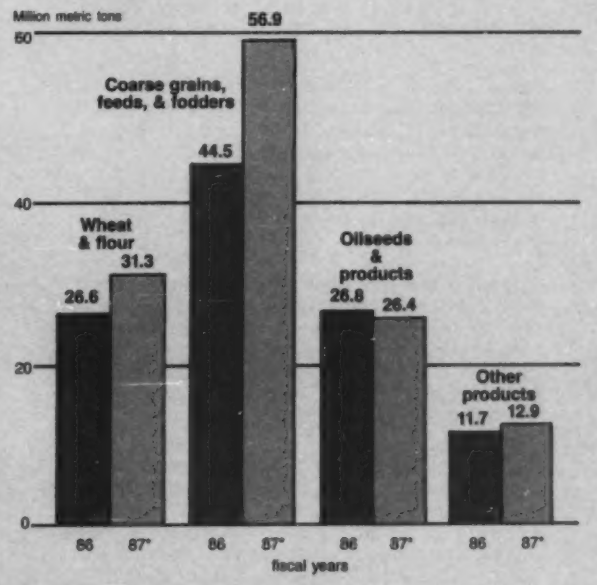
. . . And a $2 Billion Increase in Our Farm Trade Surplus



U.S. Export Volume Is Now Expected To Climb About 16% from 1986, the First Upturn in Tonnage Since Fiscal 1980's Record High



The Big Volume Gainers Are Coarse Grains and Wheat



*1987 figures are based on May 27, 1987, USDA projections for fiscal 1987 (Oct. 1, 1986-Sept. 30, 1987). Data, which were provided by economist Steve MacDonald of the Economic Research Service, will be revised and updated as the year progresses.

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